From: jthomas [jthomas@fairfaxcu.org]
Sent: Tuesday, March 31, 2009 9:22 AM
To: _Regulatory Comments
Cc: mdunn@cuna.coop; rpillow@vacul.org
Subject: Joseph Thomas - Fairfax County FCU - Comments on Advanced Notice of Proposed Rulemaking for Part 704

March 31, 2009

Ms. Mary Rupp
Secretary of the Board
National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314-3428

Re: Advanced Notice of Proposed Rulemaking (ANPR) to 12 CFR Part 704 regarding
Corporate Credit Unions

Dear Ms. Rupp:

Thank you for this opportunity to comment on the recently issued ANPR to Part 704 of the NCUA Rules and Regulations regarding corporate credit unions. Fairfax County Federal Credit Union is a community-based credit union in Fairfax, Virginia, founded in 1958, with over 21,000 members.

In response to a crucial need natural person credit unions, (NPCU) had for access to short term liquidity and investment services the corporate credit union network was created more than 30 years ago. The corporate credit union network replaced the traditional banking system for these needed services by NPCUs. As an extension of that role of liquidity provider to NPCUs, the corporate network also became the main provider of efficient settlement services to the same group.

Over the last 30 years the corporate credit union system has provided millions of Americans with access to lower cost financial services. This savings to the American people was most readily evident through membership in a credit union. However, because of a free and competitive marketplace, even non-credit union members benefited from lower cost financial services as banks and other financial institutions competed against the lower costs credit union members enjoyed, in no small part due to lower cost corporate credit union providers.

I support a strong, viable and well-managed corporate credit union network within the context of our existing, democratically controlled, cooperative-based financial institutions, known as the credit union system. The recent and possible future, losses at a few of the 28 corporate credit unions should in no way jeopardize the entire corporate credit union system. Nor should they, by extension, lessen the American people's access to affordable financial services. In order to meet the many legitimate financial product demands of NPCUs that corporate credit unions provide today even in this economic environment, corporates should be given all available tools to strengthen their position as a low cost provider of remittance payments, short and long term liquidity, as well as investment services.

I appreciate the opportunity to address issues affecting the corporate and natural person credit unions in these uncertain times through the ANPR process. I have organized my responses by categories below.

Insuring Deposits at Corporate Credit Unions

I support the NCUA's extension of deposit insurance to corporate credit unions. However the nature and premium of the insurance on deposits at a corporate credit union should be treated differently than deposit insurance at a NPCU, since deposits at a corporate credit union are almost exclusively excess deposits at insured credit unions. In effect, the funds are 'doubly insured' when placed at a corporate credit union. This difference in the level of insurance needed to adequately mitigate the risks to the NCUSIF should be reflected in the cost of such insurance to NPCU and to the corporate credit unions.

An additional avenue for NCUA to consider in regards to the cost of the insurance and capitalization would be to limit, the amount of NCUSIF insurance coverage any one particular NPCU would have at a particular corporate to an amount roughly equal to the average daily balance of all NPCUs in all corporates over a one year period. This will reduce the capitalization funding requirements and the premium amounts. Most NPCUs will gain the benefit of improved security on their deposits held at corporates while encouraging larger NPCUs the option, which they already have, of diversifying their deposits between corporates. A further benefit of this approach would be to improve competition among corporates and between corporate credit unions and other financial institutions.

Capitalization of the Corporates

Payment Systems

Corporate credit unions are the primary financial institution for the majority of NPCUs, offering full lines of account services, settlement services, payment and correspondent services, investment, and liquidity. The elimination of any of these components would reduce the corporates value as a cash management provider and effectively increase operational costs, eliminate options for member credit unions to conduct business in a cooperative system and, ultimately, result in higher costs and fees for the country's over 90 million credit union members.

Corporates should be allowed to maintain the existing business line structure. The recent crisis has underscored several best practices that should be employed, including securing multiple borrowing sources and establishing adequate cash reserves to cover unexpected short-term liquidity swings. Ensuring that funds are available to cover settlements in both normal and stressed scenarios can be achieved through existing corporate liquidity management processes and examiner review rather than having to be stipulated in regulation.

Sound regulation and policy does not eliminate risk, but rather establishes rules that measure and mitigate risks while providing a framework for long-term success. A separation of payment systems from funds management services is not practical or desirable. The business applications a corporate delivers should be determined by the NPCU members themselves after the applicable risks have been identified and appropriately mitigated.

Products and service offerings should be chosen by the corporate credit union membership, not the NCUA to meet their own identified needs. The role of the regulator is to provide oversight and enforcement of the regulations, not to make management decisions on behalf of the institutions it regulates. It is inappropriate to try to specify by regulation the types of products and services that a corporate may be allowed to offer. Corporate credit unions must be able to offer a full range of products and services which mirror their for-profit counterparts. Anything less would result in a deterioration of the current credit union system, forcing natural person credit unions to utilize profit driven competitors. The cost incurred by such measures would ultimately result in millions of dollars in expense that would have to be passed onto the private citizen.

Corporate Structure

US Central was originally established as the primary investment house for the nation's other corporate credit unions. While this two-tier corporate system has in general been an efficient mechanism of support to NPCUs for many years, US Central's overall role within the corporate network has changed with regard to the many other corporates that now offer expanded investment authorities. Inherent in a multi-tiered system is that each successive tier must be able to take on additional risk in order to provide value to the entire system. That stated, and in light of the conservatorship of US Central, it maybe time to evaluate the effectiveness of the two-tier corporate structure, especially with regard to capitalization structures and requirements.

The need for a provider of wholesale investment products to both corporates and NPCUs remains and will expand after the current economic crisis passes. However, the role of a *de facto* single provider of that service in US Central should change to that of an advisor to corporates and NPCUs.

The modified role of US Central as an investment advisor would allow for an orderly transference of the credit and concentration risk inherent in the current structure. Transitioning the concentration risks, over a period of time, from US Central onto the balance sheets of the other corporate and natural person credit unions will align the risk with appropriate levels of capital. This approach is more proportionate risk to the organization that is purchasing and holding the investments. The advantage to this plan would be the orderly transfer of assets to other organizations that could more efficiently manage the level of risk associated with a particular investment. The establishment of an appropriate CUSO could ensure that the important role of a credit union industry based settlement provider will be protected and preserved.

US Central, as an *investment* corporate, should be allowed to continue under the same regulations as other corporates so long as it can be adequately capitalized. Granted, due to the conservatorship, this may not be viable. However, if US Central survives, it could become similar to any other corporate credit union with its success based upon its competitive position and effectiveness in serving its members. It is possible that smaller corporates, many of whom have traditionally been viewed as "pass throughs" in their relationships with US Central, may elect to consider merging with the post conservatorship US Central, or its successor organization, if this would serve to make it more competitive.

Obviously, NPCUs will be able to join the "new" US Central under this proposal. Therefore, for US Central and other corporates as well, national fields of membership are appropriate in that they promote competition and limit systemic risk in a number of meaningful ways. These include the minimization of the likelihood of concentrated risk in a single corporate if a natural person credit union has no other competitive options among other corporates. While the marketplace should ultimately determine the number of corporates, I believe that through the regulatory process and appropriate supervisory actions, consideration must be given to limiting the size of any one institution that might pose a unilateral risk to the overall corporate and/or natural person credit union system.

Liquidity and Investment Authority

The corporate network can only be a significant and sufficient liquidity provider to our nation's credit unions to the extent that the individual corporates can attract deposits from their investors and owners, the natural person credit unions. Without question, corporates should have the ability to invest in instruments beyond the authority granted to a NPCU. Without such authority, the fundamental ability to meet the needs of their member credit unions will be compromised. Likewise, the inability to have expanded investment authority will adversely impact the ability of corporates to build capital.

Along with the authorization of expanded investment authority comes an increase in risk that must be balanced with enhanced capital requirements. A risk-based capital structure is needed and, as recent events clearly indicate, is clearly appropriate for corporates. In fact, a risk based capital system is likewise appropriate for all credit unions. I support NCUA adopting standards consistent with Basel I and Basel II Accords, provided that they are structured in a manner that recognizes the unique structure of credit unions as not-for-profit financial cooperatives with limited access to capital other than through retained earnings.

In any risk based capital structure for corporates, credit risk, operational risk, and market risk should all be considered and quantified appropriately based upon the individual corporate. In addition, it is my view that for a corporate risk-based system to work properly, NCUA would need to establish appropriate risk weights for: (1) government backed investments, (2) other national depositories, (3) residential mortgage obligations, (4) business obligations, and (5) asset-backed securities from sub-prime borrowers.

In addition to having capital requirements based upon their risk factors, all corporates with expanded investment authority should have to re-qualify for that authority periodically.

Capital Standards and Sources

In a letter to corporate credit unions from acting US Central CEO, Mr. Nance, he states, in effect, that due to NCUA's actions on March 20th placing US Central and WesCorps corporates into conservatorship, all corporate credit unions have lost their Paid-In-Capital and most of their Membership Capital. The removal of this capital leaves all corporate credit unions under-capitalized and subject to immediate conservatorship also. NCUA should provide both corporate and NPCUs immediate and clear guidelines regarding the circumstances under which surviving corporates will be allowed to operate with these very low capital levels. In the absence of specific guidance, NCUA should inform the credit union system of the temporary levels of capital under which corporate credit unions will be able to operate and a time frame in which they will be able to "recapitalize".

Based on the current market dislocation and the potential effects of the immediate removal of the entire corporate system due to a lack of statutory capital, I suggest that corporates be allowed to operate with an overall capital level as low as 1% for the next 12 to 18 months. Then, depending on market conditions and the actual credit risk of corporate investments, the NCUA should adjust the corporate capital levels to a conservative risk-based level.

After the adjustment period associated with the current market conditions, corporate credit union capital should consist primarily of reserves and undivided earnings (RUDE) as well as perpetual paid-in capital (PIC). PIC should only be available for investment from a member corporate credit unions and/or a NPCU. As stated in the previous section, risk-based capital standards are appropriate and should be applied relative to the corporates RUDE and PIC. Given that some corporates are in need of adding necessary capital, there should be no incongruent treatment of RUDE and PIC among corporates. Both RUDE and PIC should be included in the suggested minimum capital requirement of 4% and risk-based (Basel) of 8%.

Corporate Governance

Credit unions, including corporates, are member-owned cooperatives established for the benefit of their members and controlled by those member-owners. With a few exceptions, board members have historically been and should remain unpaid volunteers.

There is little, if any, evidence to support a conclusion that outside directors could have served to provide any higher degree of expertise or knowledge that would have helped to alleviate the current economic stress in the corporate system. Universally, the financial markets are in distress, including institutions with outside directors. Banks, brokerages, and insurance companies have all been among the financial institutions adversely impacted, facing losses and requiring government assistance to survive. Some have not been able to survive. Again, many of these who failed had outside directors. Bringing outside directors into a credit union industry based enterprise is not necessarily key to success and could actually be detrimental to the organization. Any corporate board can contract with, hire or employ whatever level of expertise it feels is needed. If objectivity would benefit the corporate beyond its normal scope of operations, then outside professional consultants are reasonable options that can be of value without having to provide a vote on the Board of Directors.

Boards of Directors do need to be representative of the membership of the corporates. The most competent and the best performing board members are always a product of ongoing education and a commitment to the industry they serve. NCUA should not mandate individual director term limits. Fresh ideas and enhanced perspectives should be considered of value by each corporate which in turn should establish some mode of evaluation within its own Board to ensure an adequate turnover process.

By virtue of the fact that the credit union industry is dealing with these issues in a straightforward manner through this ANPR, corporate credit unions and NCUA should strive to demonstrate a higher level of transparency in the disclosure of known financial conditions that have and will continue to have for the foreseeable future, serious ramifications for the credit union system and its members.

Conclusion

A healthy corporate network is absolutely necessary to provide settlement, liquidity, and investment services to natural person credit unions of all asset sizes. Of particular benefit is the role a healthy corporate credit union system plays in providing products and services to smaller and medium sized credit unions, many of whom cannot adequately replace corporate-provided services at an affordable price from the open market.

Even in these challenging economic times, I support appropriate and well-considered reforms of the corporate credit union system and understand that some action is necessary by both NCUA and the credit union community to restore confidence in the system.

Thank you for the opportunity to present these views on the future of the corporate system through this official comment letter.

Please do not hesitate to contact me if you need additional information or clarification on any of these positions advocated in this letter.

Sincerely,

/s/

Joseph D. Thomas, Jr.
President, Fairfax County Federal Credit Union
"Creating valued relationships by helping build your financial future"